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In The

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-604

MOUNTAIN FUEL SUPPLY COMPANY,
WEXPRO COMPANY, AND
ALEX OBLAD, HAROLD BURTON, AND
CARLYLE HARMON,
Petitioners,

versus

UTAH COMMITTEE OF CONSUMER SERVICES AND
UTAH DEPARTMENT OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES,
Respondents,

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF THE STATE OF UTAH

Brief *Amicus Curiae* of the
Mountain States Legal Foundation
in Support of Petition for Certiorari

MOUNTAIN STATES LEGAL FOUNDATION
JAMES G. WATT
GALE A. NORTON
1845 SHERMAN STREET, SUITE 675
DENVER, COLORADO 80203
ATTORNEYS FOR AMICUS CURIAE

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INTEREST OF THE AMICUS

The Mountain States Legal Foundation is a public interest legal center dedicated to bringing before the courts those issues vital to the protection and defense of individual liberty, freedom of economic expression, and traditional legal institutions in the United States. The Foundation, as a public interest law group which is not a party to these proceedings, is in a unique position to present a studied reflection on the impact of legal developments upon the nation.

The Foundation files this brief urging the United States Supreme Court to review the decision of the Utah Supreme Court, because the latter court has adopted a position which is an extreme departure from constitutional and statutory principles of law. If allowed to stand, the decision will significantly alter American and Utah jurisprudence, will dramatically and adversely impact the development of energy resources in Utah and the West, and will severely damage the

interests of utility ratepayers, shareholders, the general public and the private enterprise system. Furthermore, the Utah court decision seeks to impose a new order of economic rights which allows the confiscation of a portion of shareholders' earnings.

Mountain States Legal Foundation has received written consent from all parties to file this brief as *amicus curiae*. Copies of these letters have been filed with the Clerk of the Court.

QUESTION PRESENTED

Does the Utah Supreme Court's decision undermine federal and state economic, regulatory, and energy policies, violate private property rights, and damage the American private enterprise system to such a degree that review of this Court is imperative?

SUMMARY OF THE ARGUMENT

Through a decision which violates provisions of the Constitution and of federal and state statutes, the Utah Supreme Court has formulated a theory that will disrupt the economic, regulatory and energy policies established by the Congress, the legislatures, and the courts. The decision will erode the concept of private property rights by allowing shareholders' earnings from a non-utility business to be confiscated without due process. It will impair exploration for petroleum resources by obstructing joint venture efforts between public utilities and independent oil companies. The decision sacrifices the long-term interests of energy consumers by destroying an active and successful petroleum exploration program. If allowed to stand, the decision will establish precedent that will significantly reduce oil and gas production throughout the West.

The severe and possibly unanticipated consequences of the Utah decision create an urgent need for review by the Supreme Court of the United States.

ARGUMENT

The decision of the Utah Supreme Court is seriously flawed from a legal standpoint because it totally disregards important statutory and constitutional provisions. The court's decision imposes state regulation in an area of federal preemption, takes private property without due process and just compensation, and burdens interstate commerce. Because the Utah Supreme Court's decision was a significant departure from established legal principles, the Foundation presented to the Utah court a brief in support of Mountain Fuel Supply

Company and Wexpro Company's petition for rehearing. The brief covered the law on four points: improper judicial fact-finding, the court's misunderstanding of regulatory concepts, the extra-territorial expansion of Utah jurisdiction over natural gas production in Wyoming and other Western states, and federal preemption of the regulation of crude oil sales. The Utah Supreme Court ignored these issues, which have now been presented to this Court in the Petition for a Writ of Certiorari.

This *amicus* brief will not reiterate the legal challenges to the Utah Supreme Court decision. Instead, this brief will discuss the drastic social and economic ramifications of the decision that urgently demand United States Supreme Court review.

I.
THE UTAH SUPREME COURT DECISION ORDERS THE CONFISCATION OF THE SHAREHOLDERS' EARNINGS (PRIVATE PROPERTY) DERIVED FROM NON-UTILITY BUSINESS ACTIVITIES.

For many years the courts have struggled to define the nature of public utility businesses. In order to protect the public from exploitation by natural monopolists, both federal and state governments established regulatory mechanisms for simulating the controlling effects of the competitive marketplace. The primary duty imposed upon those businesses designated as public utilities was to provide adequate service at a reasonable price. 1 A. Priest, Principles of Public Utilities Regulation 3-5 (1969). *See also Northern Pacific Ry. v. North Dakota ex rel. McCue,* 236 U.S. 585 (1915); *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591 (1944).

The decision of the Utah Supreme Court goes far beyond these historically accepted guidelines and imposes a requirement that is inconsistent with the principles of a capitalist economy. An investor-owned utility company should retain its essential character as a private enterprise despite its utility transactions. When it has fulfilled its duty to provide adequate service at a reasonable price, it has met its responsibility to the public.

There are definite limits upon the duties of a public utility company, and state regulation cannot demand public services beyond those bounds. In the *Northern Pacific* case, this Court held that

> the public interest cannot be involved as a

> justification for demands which pass the limits of reasonable protection, and seek to impose upon the carrier [i.e., the public utility] and its property burdens that are not incident to its engagement. 236 U.S. at 595.

Thus a public utility cannot be required to dedicate a non-utility business to the public good without due process and just compensation. The Utah decision would illegally require Mountain Fuel to devote its oil business to the public use, in violation of the shareholders' constitutional rights.

The *Northern Pacific* decision makes clear that the Utah Supreme Court's holding would extend the Public Service Commission jurisdiction beyond its constitutional limits.

> The constitutional guaranty protects the carrier [public utility] from arbitrary action and from the appropriation of its property to public purposes outside the undertaking assumed. 236 U.S. at 604.

Under the Utah decision, the state would regulate not only those shareholder properties devoted to public service as "public utilities," but regulation would also be expanded to include those properties intended to be handled as separate, private businesses.

There is a subtle but crucial distinction between requiring a utility to provide its utility services at a reasonable rate that approximates a competitive market price and, on the other hand, forcing a utility to subsidize its utility rates by using earnings derived from non-utility activities. The utility should provide services at cost plus a reasonable profit; it should not be forced to provide services at less than cost whenever an unregulated subsidiary enters into a profitable venture.

The new Utah brand of public utility law provides that a customer who purchases goods acquires an ownership right, (i.e., the right to share in the earnings) in the company that produces those goods. When stripped of its public utility and petroleum exploration jargon, the Utah Supreme Court holding becomes patently confiscatory.

A simple example will serve to illustrate the inconsistency of the Utah Supreme Court decision with the traditions of a free-enterprise economy. The provision of natural gas to consumers can easily be analogized to the sale of a manufactured product. Whenever a consumer purchases an item in a store, a portion of the price of that item will include the costs of research and development for new products, marketing

research to open new stores, and advertising to attract new customers. Obviously, however, the consumer does not become automatically entitled to a share of the profits from the new products or new markets merely because a part of his purchase price covered those business expansions. Likewise, the consumer of natural gas services does not acquire an ownership interest in the utility by paying a portion of the cost-of-service price for exploration. However, the situation presented to the Court here is even more clearcut — earnings involved are those of a *non-utility* business conducted by the privately owned utility.

The position of the Utah Supreme Court is directly contrary to that adopted by this Court in *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23 (1926). This Court recognized that a privately owned utility is not a trustee for its customers; rather, it operates under the same basic principles as any other business. "The revenue paid by the customers for service belongs to the company." 271 U.S. at 31. Furthermore, this Court emphasized that customers are not owners entitled to share in earnings: "By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company." 271 U.S. at 32.

One final point raised by the *New York Telephone* decision should be emphasized at this time. The decision dealt specifically with the use of an amount in a reserve depreciation account to offset current expenses and thereby to lower rates below those which could be otherwise sustained. The Court held: "Profits of the past cannot be used to sustain confiscatory rates for the future." 271 U.S. at 32. The Mountain Fuel/Wexpro situation is essentially similar. The only difference is that, rather than applying past accumulations of financial reserves to offset current expenses, the Utah court is attempting to apply a corporate subsidiary's non-utility earnings to offset utility expenses. Profits from non-utility activities cannot be used to sustain confiscatory rates for utility services. *See Cleary v. Chalk*, 488 F.2d 1315, 1324 (D.C. Cir.), *cert. denied*, 416 U.S. 938 (1973), which held that "[i]t is well settled that income received by a public utility from nonoperating property is not to be considered in establishing the rate. . . ."

The Utah Public Service Commission is charged, as regards Mountain Fuel, with regulating natural gas rates. It is not statutorily entitled to regulate oil developers. Yet the state court's decision would vest this power in the Commission. The

reasonable cost of providing gas does not vary with the rise or fall of oil prices; the oil business is separate. To consider its losses in determining the cost of providing natural gas would be unfair to consumers; to consider its gains would be to confiscate the non-utility property of the shareholders. The Mountain Fuel oil business has never been considered a utility business. Even if the Utah Public Service Commission attempted to regulate the oil operations directly, it would be prohibited from doing so through preemption by the federal government. (The preemption issue is more fully discussed in the Petition for a Writ of Certiorari.)

Utility regulators may be justified in ignoring the legal fiction of a separate corporation when a utility company purchases goods or services from an affiliate at a higher price than it would pay on the open market, the affiliate thus being used as a means of gaining hidden profits. No such allegation is made here. The conditions of any sales of natural gas by Wexpro to Mountain Fuel were explicitly spelled out by the original Utah Public Service Commission decision, and the legitimacy of such regulatory action is not challenged.

In the broader context, this case must be seen as an erosion of the concept of private property rights. The Utah Supreme Court has asserted that the shareholders of a corporation cannot devote a portion of that organization's assets to the public service unless they are willing to so devote the entirety of corporate and subsidiary property. This assertion would discourage corporations, particularly those engaged in other profitable business ventures, from entering the public utility area. The state court has also asserted that the judiciary can act, without seeking legislative direction, to declare that private property has been transformed into public utility property. And finally, the Utah court has ignored prior United States Supreme Court decisions limiting the extent of regulation of utility companies. This unprecedented dilution of private property rights will undoubtedly have a destructive impact upon the American free enterprise system.

II.
THE UTAH COURT'S DECISION WOULD REQUIRE GOVERNMENT REGULATION OF INDEPENDENT BUSINESSES, THUS DISCOURAGING NEW DEVELOPMENT OF NEEDED ENERGY.

The Utah Supreme Court's statement of the Wexpro actions that render it a public utility is so broad that it will encompass

the actions of any independent gas producer that enters into a joint agreement with Mountain Fuel. The court has ruled:

> Wexpro, by its joint activities with Mountain Fuel, particularly upon the transferred properties is both performing a service, viz., facilitating the production of natural gas, and delivering natural gas to its parent, both of which constitute Wexpro a public utility. Petition for a Writ of Certiorari at A13.

This ruling creates the possibility of unwarranted expansion of Utah Public Service Commission jurisdiction. Consequently, it is likely that Mountain Fuel will be unable to secure new sources of natural gas from independent natural gas operators. Few, if any, Utah gas well owners would want to subject themselves to regulation by the Utah Public Service Commission. Operators in states other than Utah would also be threatened by this ruling merely because they have furnished natural gas to Mountain Fuel. This raises the spectre that an independent producer would be subject to regulation by any state in which one of its customers was regulated. Clearly, this would lead to conflicting regulations and is precisely why federal regulation has preempted the oil and gas area. Not only would this regulatory complication seriously diminish Mountain Fuel's ability to attract joint venturers, but it would impose a threat of taking without due process upon any independent producer that did enter into such an agreement.

The joint venture concept is extremely important to the entire petroleum industry. In order to spread the risks of exploration, producers often share expenses and responsibilities for exploration of a given tract of land. The joint venture practice makes entry by small producers more feasible, since it allows them to diversify the risks involved in encountering a dry hole. A small company with all of its capital concentrated on one project would be easily ruined by an unsuccessful drilling project, while one that had its capital spread among several joint venture projects would be considerably more stable. Inhibitions of joint exploration agreements would thus have a seriously detrimental effect upon the competitive structure of the oil and gas production industry by forcing small independent producers out of the market. Potentially even more serious is the interference with oil and gas exploration. Today, there are over 12,000 independent petroleum producers. This group is responsible for 90% of all wildcat wells and 80% of all drilling in the continental United States. The vast majority of these activities are undertaken as

joint ventures.

The serious and far-reaching consequences of discouraging joint venture agreements should not be instituted without study and contemplation. This Court should grant certiorari to halt the possibly unforeseen and unintended results of the Utah decision.

III.
THE UTAH DECISION WILL DESTROY AN ACTIVE AND SUCCESSFUL EXPLORATION PROGRAM, AND IF CONSIDERED AS PRECEDENT, COULD SERIOUSLY REDUCE EXPLORATION ACTIVITIES THROUGHOUT THE NATION.

A vigorous exploration program is necessary for the success of any fossil fuel producer. On a national scale, exploration is necessary to alleviate petroleum shortages and maintain the health of the national economy. Exploration becomes more difficult and costly over time as easily accessible reserves are depleted.

The overriding necessity for exploration, under the Utah Supreme Court decision, is sacrificed to the political expediency of reducing immediate costs to ratepayers. The determination of whether the public interest is more readily served by short-term price reduction or by long-term increase in fuel production should involve fact-finding with adequate information, deliberation, and expertise. The Utah Public Service Commission, a body that devoted considerable time and expertise to this process, placed its emphasis on balancing the legal rights of all parties and upon future development of adequate supplies of natural gas.

It is a guiding principle of the American free enterprise system that production is encouraged by profit incentives. The American public service industry is over 80% owned by private interests. Dibee, *The Functions of Profits in Industry in General and in Regulated Public Service Industries in Particular,* in NEW CONCEPTS AND CURRENT ISSUES IN PUBLIC UTILITY REGULATION 159, 162 (B. KOLB AND O. LIPSTREN, eds., 1963). Functions of profits include attracting necessary capital, making growth possible, providing management incentive, and facilitating research and development of exploration activities. Gifford, *Functions of Profits in Public Service Industries,* in B. KOLB AND O. LIPSTREN, *supra,* 166, 167.

These factors, combined with other basic realities of business, illustrate why it is almost universally recognized that earnings provide incentive for public utilities as well as for private industry. The importance of a reasonable rate of return on investment is emphasized throughout public utility law, from the early case of *Smyth v. Adams,* 169 U.S. 466 (1898), to current public utilities cases.

The central concept of the investor-owned utility must be remembered — that of a privately owned business whose property has been dedicated to the public use. Investors are to be reasonably compensated for this use of their assets. This case does not, however, involve an ordinary determination of rate of return. It involves the extent to which a non-utility operation may be pressed into service as a public utility without due process, such that its probable earnings will be reduced significantly and utilized to subsidize other traditional public utility functions.

In this time of energy crisis and shortage of fuels, it is not wise to diminish earnings of small producers and thereby inhibit exploration for and production of new energy supplies. Despite the current image of high oil industry profits, competitors in the industry are not assured instant success. This is an industry where high costs for exploration must be incurred, and where unsuccessful drilling projects are many times more common than successful ones. The effect of the Utah Supreme Court decision will be to cause the Wexpro/Mountain Fuel shareholders to operate an oil production business at a rate of return significantly below that of the rest of the industry. This is in direct conflict with accepted public utilities law requiring returns "commensurate with returns on investments in other enterprises having corresponding risks." *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944).

However, the Utah decision is particularly egregious because it will significantly expand the scope of state regulation by indirect means, without ever making the determination that the oil industry is a public utility industry under Utah law. (The Utah court's authority to make such a legislative decision that would operate in an area of federal preemption is certainly not conceded.)

In addition, the unconstitutional Utah Supreme Court decision would remove from management discretion one tool that has been used by public utility management to attract capital and assure availability of funds for corporate growth without raising the costs to utility customers, i.e., prudent investment in non-utility activities. The higher return possible on these

investments makes equity capital more readily available, but because it is conducted separately from the utility business, the utility ratepayer bears no burden of risk or involvement.

The net effect of the Utah decision, if allowed to stand as precedent, will be to discourage the entry of natural gas producers into oil exploration and to diminish the exploratory activities of existing oil and gas producers. This short-sighted holding will inevitably cause decrease availability of fossil fuels, will raise utility rates, and will work to the detriment of the consumers in the State of Utah.

CONCLUSION

The foregoing discussion highlights the reasons that Mountain States Legal Foundation believes United States Supreme Court review to be imperative.

It is clear that the Utah decision is invalid, based upon the legal reasons outlined in the Petition for Certiorari. The legal infirmities of the Utah decision indicate a need for Supreme Court review.

The widespread economic chaos that will result from this decision makes Supreme Court intervention imperative.

Respectfully submitted,

JAMES G. WATT
GALE A. NORTON
1845 SHERMAN STREET, SUITE 675
DENVER, COLORADO 80203
ATTORNEYS FOR AMICUS CURIAE
MOUNTAIN STATES LEGAL FOUNDATION